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232-029—66——1

CITATIONS

In the Supreme Court of the United States

October Term, 1966

No. 9

United States of America, appellant

v.

Sealy, Inc.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The district court rendered no opinion. Its findings of fact and conclusions of law (R. 63–152) are unreported.

JURISDICTION

This is a civil antitrust action brought by the United States under Section 4 of the Sherman Act, 15 U.S.C. 4. The final judgment of the district court (R. 153–156) was entered on December 30, 1964. On February 26, 1965, the United States filed a notice of appeal to this Court (R. 157), and on October 11, 1965, this Court noted probable jurisdiction of the appeal (R. 160; 382 U.S. 806). The jurisdiction of this Court to review the judgment below on direct appeal is conferred by Section 2 of the Expediting Act, Febru-

ary 11, 1903, 32 Stat. 823, as amended, 15 U.S.C. 29. *White Motor Co.* v. *United States*, 372 U.S. 253; *United States* v. *Masonite Corp.*, 316 U.S. 265.

QUESTION PRESENTED

Sealy, Inc. is a corporation holding trademarks on bedding products. Sealy is owned and controlled by approximately 30 bedding manufacturers to whom it has licensed the right to manufacture and sell bedding under its trademarks in mutually exclusive territories. The question presented is whether this allocation of territories violates Section 1 of the Sherman Act.

STATUTE INVOLVED

Section 1 of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. 1, provides in pertinent part:

> SEC. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal * * *.

STATEMENT

This case began as a civil action, brought by the United States, charging that Sealy, Inc. had violated Section 1 of the Sherman Act by conspiring with manufacturers who make and sell bedding products under Sealy's trademarks to fix the retail sales prices of such bedding products and to allocate mutually exclusive sales territories.[1] After trial, the district

[1] Three other cases were brought at the same time which challenged price-fixing and territorial allocation arrangements virtually identical to the ones challenged in this case. In two of these cases consent decrees were entered in which the com-

court held that Sealy had violated Section 1 by agreeing with the manufacturers upon minimum retail prices and by inducing retailers to adhere to such prices, and issued an injunction (R. 153–156). But it held that the exclusive territorial arrangement did not violate antitrust law and dismissed that count of the complaint. Since Sealy did not appeal the finding of illegal price-fixing, the sole issue here is the legality of the territorial restriction. On that issue the district court's findings and the undisputed documentary evidence show the following:

The Sealy trademark was first registered by the Sealy Mattress Company, a division of Sugar Land Industries (Fdg. 17, R. 68), and until about 1920 Sealy products were manufactured solely by the Sealy Mattress Company at its four factories in the midwest and southwest. In the early 1920's, Sugar Land Industries began licensing independent bedding manufacturers to manufacture bedding products under the Sealy name, and by 1923 some 19 independently owned factories were operating under Sealy licenses (Fdg. 18, R. 68; Tr. 58). In 1923, Sugar Land decided to withdraw from the bedding business, and granted an option to purchase all of Sealy's intangible assets (license contracts as well as trademarks) to E. E. Edwards (Fdg. 18, R. 68; GX 2A, R. 186–188), who together with the Sealy licensees created a separate corporation to exercise his option. This cor-

panies agreed to eliminate territorial restrictions. *United States* v. *Restonic Corp.*, 1960 Trade Cases ¶69,739 (N.D. Ill.); *United States* v. *Spring-Air Co.*, 1962 Trade Cases ¶70,402 (N.D. Ill.). The other case is awaiting trial. *United States* v. *Serta Associates, Inc.* (N.D. Ill., Civ.—60-C-843),

poration (Sealy Corporation), the stock of which was owned by Edwards and the licensees, licensed the use of the Sealy mark to the independent bedding manufacturers who held stock in it, but it did no manufacturing itself (Fdgs. 19–22, R. 68–69; GX 1, R. 161; GX 2A, R. 168–171).

Beginning in 1925 the licensees agreed upon a system of allocating exclusive territories for the marketing of Sealy products. Each manufacturer was assigned an exclusive territory in his license contract and prohibited from selling Sealy products outside of that territory (Fdg. 27, R. 72; GX 4, R. 205; GX 27, R. 234–261). Although territorial boundaries were originally determined by freight costs, the licensees voted in 1925 to fix boundaries permanently and to disregard future changes in freight rates (Fdg. 28, R. 72–73; GX 4, R. 205). Subsequently, however, the stockholders authorized the president to redetermine territories so that each licensee's sales area would be proportional to his shareholding of Sealy stock (GX 31–E, p. 3–7247 (unprinted)).

In 1933, when the number of Sealy licensees had dwindled to eight (primarily because of "depression-caused financial difficulties"), Sealy Corporation was reorganized into the present Sealy, Incorporated (Fdgs. 32–35, R. 74–75). At the first executive committee meeting following the reorganization a proposal "to divide the entire United States between the present group [of licensees] was seriously considered and discussed at length" but was rejected (Fdg. 86, R. 91–92; GX 8, R. 213). The licensees agreed, however, to continue the system of exclusive terri-

tories (Fdg. 27, R. 72; GX 8, 214; GX 27, R. 234–261). To discourage incursions, the licensee-manufacturers agreed to pay a fine of $10 to Sealy, Inc. for each violation of a neighboring licensee's territory. Sealy, Inc. would then turn over the fine to the licensee whose territory had been violated (see, *e.g.*, GX 1012, R. 1001–1002). With the Sealy price scale beginning at $19.75, the $10 fine represented as much as 50 percent of the selling price of a number of items in the Sealy catalog (Fdg. 128, R. 105; GX 31–E, R. 273). Provision was made for expansion of the Sealy group by the allocation of territories to new licensees, but it was stipulated that any new manufacturer coming into the organization would be required to purchase stock in Sealy, Inc. in order to qualify it "as one interested in [Sealy's] success." (GX 31–E, R. 272.)

In the 1940's, Sealy's royalties began to increase; merchandising, advertising, and research were stepped up; and many new licensees were brought in to cover territories that had previously been left open (Tr. 66–73). When disputes over the territorial boundaries arose between licensees, Sealy encouraged the disputants to resolve their differences among themselves (Fdg. 30, R. 73).[2] Sealy's usual position in territorial disputes was that of an impartial referee whose

[2] For example, in the spring of 1948, the Los Angeles and Denver licensees each claimed the right to serve the State of Arizona, and the Los Angeles licensee wrote to the president of Sealy, Inc. (GX 167, R. 416):

> * * * It appears from Morris Stein's answer to my letter that it will be up to the Executive Board or Board of Directors

function was to keep peace among its licensees (see, *e.g.*, GX 164–175, R. 410–430; GX 205–206, R. 473–474; GX 229, R. 501–502; GX 243–A–244, R. 518–519; GX 248–A, R. 523–524; GX 268, 272; R. 543–544, 549).

Approximately 30 licensees—all of whom hold stock in Sealy, Inc.—are currently manufacturing bedding products bearing the Sealy label (Fdg. 12, R. 66; GX 31–F, R. 277; GX 1012, R. 997). The licensees as a group own approximately 90 percent of the stock,

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> to adjudicate and protect Sealy of California's franchise rights for the Arizona and Nevada territories.
>
> We leave this matter in your capable hands.

The president responded (GX 167–A, R. 417–418):

> * * * [T]his letter is written to both parties with the thought in mind of trying to bring this thing to an amiable conclusion without the necessity of action on the part of either the Committee or the Board.
>
> *　　　*　　　*　　　*　　　*
>
> I think the proper approach to this matter would be for each of you to sit down and compile a history of the business that you have conducted in Arizona by years and an outline of the exact territories that you have been servicing. With this information at hand * * * [you] should be able to come quickly to some amiable handling. * * *

Two months later, Sealy's president again wrote the two licensees (GX 169–A, R. 423):

> I hope that by this time you two boys have been able to get your maps out and have decided on the exact line of demarcation of the Arizona Territory.
>
> As soon as you have come to a gentleman's agreement relative to same, will you please advise me, so that we in the national office may prepare a supplement covering same?

Finally, in March 1949, the licensees advised Sealy that they had divided up the Arizona territory in a manner that suited them (GX 173–A, R. 428).

with no single licensee owning more than 14 percent; the remainder of the stock is held by Sealy officers (see GX 985, 991–D, R. 957–959). Sealy's bylaws limit membership on its board of directors to stockholders and to representatives of licensees (GX 31–F, R. 277; GX 981, R. 948).

Sealy's activities include coordinating and placing national advertising, engaging in product research, registering new marks, and seeking out new licensees (it does no manufacturing itself). Sales of trademarked bedding by all licensees totalled $56.4 million in 1958, and $58.6 million in 1959, generating royalty income for Sealy, Inc. of $1.2 million and $1.4 million in those years. The income of individual licensees ranged between $533,000 and $6.5 million, with more than three-fourths falling into the $1–$3 million range. (Fdgs. 11–14, R. 66–67.)

Despite the expansion that has taken place since 1933, the corporate structure of Sealy, Inc. and the operation of the territorial allocation plan remains basically unchanged. Each licensee is restricted to sales within his allotted territory. Sales outside of that territory, or sales within the territory to a distributor or dealer planning to resell outside, are expressly forbidden by the contract between Sealy and the licensee. (GX 1012, R. 1002; GX 1014, R. 1019; GX 1015, R. 1035; GX 1016, R. 1051; GX 1017, R. 1097; GX 1018, R. 1118; GX 1020, R. 1163; GX 1051, R. 1182; GX 1061, R. 1199; GX 1064, R. 1219; GX 1065, R. 1240; GX 1074, R. 1262; GX 1085, R. 1282; GX 1086, R. 1303.)

ARGUMENT

Introduction and Summary

The appellee—Sealy, Inc.—is a joint venture of a number of bedding manufacturers to hold and exploit the "Sealy" trademark. Each of the manufacturers is licensed by Sealy to manufacture and sell "Sealy" bedding in a particular area and permanently forbidden by the license agreement to sell elsewhere. The sole issue here is whether this territorial restriction shall be deemed an unlawful trade restraint under Section 1 of the Sherman Act without a trial upon the issues of competitive effect and economic justification—in terms familiar to antitrust, whether the restriction is illegal *"per se"*. Since it is well settled that agreements between competing sellers to divide marketing territories are illegal *per se*, the question may also be stated as whether a different rule should govern an indefinitely continuing division effectuated through the kind of trademark licensing arrangement employed by the Sealy companies.

To frame the issue, it is necessary to consider briefly the nature and rationale of *per se* rules. These are simply substantive rules of antitrust law which the courts have developed in the course of applying the general language of Section 1 of the Sherman Act to concrete cases. Where the complaint charges a *per se* violation, the only factual issue is whether the defendant engaged in the practice alleged—not whether, in the circumstances of the particular case, the adverse competitive effects of the practice so outweigh any asserted justifications as to make the practice an

unreasonable restraint of trade. *Northern Pac. R. Co.* v. *United States,* 356 U.S. 1, 5.

The *per se* principle is thus one of judicial economy, enabling drastic simplification of the issues in many antitrust cases. This Court has often remarked upon the exigent need for such simplification. *E.g., Northern Pac. R. Co.* v. *United States,* 356 U.S. 1, 5 (n. 3, *infra*); *United States* v. *Philadelphia National Bank,* 374 U.S. 321, 362; *Standard Oil Co.* v. *United States,* 337 U.S. 293, 313. Proliferation of the areas of factual inquiry makes antitrust litigation protracted, unwieldy, and expensive, straining the resources of government enforcement agency and private litigant alike. Moreover, the litigation process is ill suited to the digesting and ordering of complex masses of economic data; therefore, broadening the scope of inquiry to include every conceivably relevant fact may more often impair than enhance the correctness of the decision. Most important, perhaps, simplification of substantive antitrust principles is necessary if the antitrust laws are to be reasonably certain and predictable in their application; and without reasonable certainty, widespread voluntary compliance with those laws can hardly be expected.[3]

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[3] As the Court explained in the *Northern Pacific* case (356 U.S. at 5)—

> This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often wholly fruitless when undertaken. * * *

These are weighty considerations in antitrust administration. They have properly been held to justify blanket condemnation of a number of business practices which in a few cases may be harmless or even beneficial. Price fixing is perhaps the classic example of a practice so inherently opposed to the policy of competition embodied in the antitrust laws that it is condemned without consideration of the actual impact upon that policy in the particular case. Yet doubtless some price-fixing conspiracies have negligible or no adverse effect on competition or the price level—because they are not enforced or adhered to, the conspirators do not control a sufficiently largepart of the market, there is adequate competition from substitute products, or the conspirators accidentally fix the price at the same level that free competition would have determined.[4] The courts, however, have uniformly deemed these considerations inadmissible—and rightly so. The probability of substantial competitive harm inherent in price-fixing conspiracies is too great, and the possibility of justification both too remote and too indeterminate,[5] to justify the loss in certainty and simplicity of administration that abandoning a *per se* approach would produce.

A similar analysis leads to the conclusion that the

[4] Conceivably, a very few price-fixing agreements may even be beneficent, by, for example, so minimizing severe market risks in highly cyclical industries as to lower long-run capital costs.

[5] For it will never be possible to know to what extent the actual motive of the agreement was merely to obtain greater than competitive profits.

type of arrangement for dividing territories involved in this case falls within the forbidden category. Its effect on competition is, if anything, more drastic than that produced by fixing prices: the direct elimination of all—not merely price—competition in the sale of the licensed product. This effect is not likely to be offset by competition from other brands, for the entire Sealy program presupposes that the Sealy brand has a distinct consumer appeal which insulates it, within a range at least, from the competition of other bedding brands.

The adverse effect of the territorial restraint cannot be justified as necessary to strengthen interbrand competition. First, the severity of the restraint far exceeds (as we show) what is reasonably necessary to protect the Sealy group's legitimate interests. Second, since the restraint is in effect imposed by the very firms (Sealy's licensees) who thereby achieve insulation from competition, one is entitled to view with considerable skepticism a claim that the purpose of the restraint is not to enable each seller to reap greater than competitive profits but to enhance interbrand competition. Nothing is more deeply rooted in our antitrust tradition than distrust of collaboration among competitors as a method of economic ordering.

The present case in thus significantly different from *White Motor Co.* v. *United States,* 372 U.S. 253. In that instance territories were allocated by a single manufacturer among his distributors and it could be argued that the restriction was imposed in the interest of the manufacturer as a necessary step to achieve effective distribution. Here, however, exclusive ter-

ritories were allocated among manufacturers of the same product by a trademark licensor whom they controlled, and while we do not argue that Sealy, Inc. was no more than a facade for a conspiracy to suppress comptition (it had other purposes which were lawful) there is no escaping the conclusion that in such a case—unlike a true "vertical" restraint—competition has in effect been eliminated by the action of the competitors themselves.

Thus the case closely resembles the classic division-of-territories agreement whose *per se* illegality is conceded. *United States* v. *Addyston Pipe & Steel Co.*, 85 Fed. 271 (C.A. 6), affirmed, 175 U.S. 211; *United States* v. *National Lead Co.*, 63 F. Supp. 513 (S.D.N.Y.), affirmed, 332 U.S. 319; *Timken Roller Bearing Co.* v. *United States*, 341 U.S. 593. It is immaterial that the division is among sellers of the same brand; for the rule against resale-price-maintenance agreements attests that the interest in vigorous intra-brand competition is sufficient to support a *per se* rule against territorial restraints of long or indefinite duration. It is immaterial that the division was nominally imposed by a third party (Sealy), for that third party is controlled by the sellers whose territories it allocated. And it is immaterial that the allocation arises in the context of a trademark licensing arrangement, for the trademark law confers no antitrust immunity.[6] One other difference between

[6] The Lanham Act expressly provides that a trademark may not be "used to violate the antitrust laws of the United States" (Section 33(b)(7), 15 U.S.C. 1115(b)(7)), and this Court has held specifically that trademarks may not be used as a justification for dividing territories among competitors. *Timken Roller*

this case and the classic division-of-territories case lies in the fact that the agreement here is part of a joint venture by a group of manufacturers to supply themselves with a national brand name. But the difference is quite unimportant. Although temporary territorial restrictions ancillary to a legitimate joint venture may perhaps be justified if they promote new entry, the permanent restrictions at issue here, imposed by a well-established firm, cannot be defended upon such basis.

I. THE HARMS TO COMPETITION WHICH INHERE IN THE TERRITORIAL RESTRICTION OF THE SEALY LICENSING AGREEMENT ARE GREAT. THEY ARE NO LESS THAN THOSE OF PRACTICES TRADITIONALLY CONDEMNED AS ILLEGAL *PER SE*.

The Sealy plan of territorial allocation, embodied in every Sealy licensing agreement, divides the nation into as many areas as there are licensees and assigns each licensee to a different one of these areas. The licensee may not manufacture or sell Sealy-brand bedding outside his assigned area, nor may he sell within the area to a dealer or distributor who intends to resell without. Under such an arrangement, the production and sale of the branded product is

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Bearing Co. v. *United States*, 341 U.S. 593, 598–599. Moreover, any controls upon a trademark licensee must be "legitimate" (15 U.S.C. 1055, 1127), this provision having been added at the urging of the Antitrust Division to prevent abuse of the licensing privilege. Hearings on H.R. 82 before a Subcommittee of the Senate Committee on Patents, 78th Cong., 2d Sess., pp. 58–71. See, also, Schniderman, *Trade-Mark Licensing—a Saga of Fantasy and Fact*, 14 Law & Contemp. Prob. 248, 260–261; Note, 68 Harv. L. Rev. 814, 899–900.

divided up into a series of regional monopolies. Competition at the manufacturing level is totally foreclosed. The foreclosure is even more complete than that effected by a price-fixing agreement, under which the parties are free to compete in respects other than price.

Nor can it be doubted that significant competition in the sale of the brand is in fact eliminated by the restriction. If freight or other cost barriers locked each licensee into his allotted area, there would be no occasion to forbid him to sell outside, and licensees would not—as appellee admits and emphasizes they do—insist upon the protection of the territorial restriction (Motion to Affirm, pp. 10–11, 15–16).

It is true that the restriction does not shield the licensees from competition from other brands of bedding. But this is not to say that it is ineffectual to give each licensee a significant power over price and quantity—a monopoly, albeit (like all monopolies) a limited one, which he would not otherwise enjoy. The proclaimed purpose of Sealy, Inc. is to create a distinct consumer preference for Sealy over other brands of bedding, and we cannot assume that the extensive advertising and promotional efforts of Sealy and its licensees have failed to create a distinctive image and unique demand for Sealy bedding—a degree of differentiation sufficient to give each licensee a margin of freedom in pricing Sealy products[7] so long as he is protected from the competition of other licensees. See, *e.g.*, Bain, *Barriers to New Competition*, pp.

[7] Sealy licensees are free to sell other brands without any territorial restriction.

114–115; cf. *Federal Trade Commission* v. *Borden Co.*, 383 U.S. 637.

Were that not so, it would be difficult to understand the licensees' insistence (see p. 14, *supra*) upon territorial exclusivity. Protection from the competitive inroads of the relatively few manufacturers who compose the Sealy system and who in the aggregate compose but a small segment of the bedding industry would be futile if the competition from other brands were as effective as competition within the Sealy family. The principal justification suggested by appellee for the territorial restriction—that Sealy cannot attract licensees without offering them protection against competition from existing licensees—presupposes that the restriction is an effective method for reducing the competitive pressures upon the manufacturers who are party to the scheme.

In this respect the restriction at bar is very much like a price-fixing agreement. In price-fixing cases, delineation of a relevant market is not required, proof that the parties occupy a dominant market position is inadmissible, and agreements involving sellers of a single brand are proscribed without regard to the strength of the competition from other brands (*e.g.*, *Dr. Miles Medical Co.* v. *Park & Sons Co.*, 220 U.S. 373). This drastic limitation of proof is justified by the invidious purpose of all price-fixing agreements—to place a floor under the parties' prices. To be sure, that purpose can be achieved only if the parties have some power over price—some range within which they are insulated from attempts of sellers who are not

parties to the agreement to cut prices.[8] Lacking such power, sellers who make price-fixing agreements are engaged in an exercise in futility. The rare instances in which such efforts are pointless hardly deserve consideration. The policy of antitrust law warrants condemnation of the effort itself. *A fortiori,* it warrants the conclusion that these possibilities may be disregarded in formulating general rules.

The agreement to divide territories that is in issue here likewise presupposes that to grant each licensee an exclusive territory is to give him substantial protection against competition. In these circumstances, we believe it appropriate to presume without evidentiary inquiry the adverse competitive impact of the restriction. But we do not argue that this in itself justifies the application of a rule of *per se* illegality. It is also necessary to consider whether the likelihood that the restraint, notwithstanding its severity, may have a pro-competitive justification is sufficiently great to warrant putting the issue of justification to proof.

II. THE POSSIBILITY THAT THE SEVERE RESTRAINT INHERENT IN THE PERMANENT DIVISION OF TERRITORIES HERE (A RESTRICTION IMPOSED, IN EFFECT, BY THE SELLERS THEMSELVES) IS A JUSTIFIED ONE IS TOO REMOTE TO WARRANT A TRIAL ON THE POINT. A RULE OF *PER SE* ILLEGALITY IS THEREFORE APPROPRIATE.

In Point I, we considered the dangers to competition presented by a territorial restriction like that at

[8] The Sealy manufacturers assumed they had this power—for, the district court found, they conspired to fix the resale price of Sealy products. They could not have done this successfully if other bedding was completely interchangeable with Sealy bedding in the consumer's mind.

bar, and we concluded that their substantiality was too clear to require proof. But what of the possible redeeming benefits of such restrictions? May they outweigh the harms in enough cases to make a rule of *per se* illegality inappropriate? These questions remain for our consideration.

A. THE POSSIBLE JUSTIFICATIONS ARE TENUOUS IN THE EXTREME

We begin by reviewing the justifications that have been—or could be—advanced in defense of an allocation, unlimited in duration, of exclusive territories among licensed manufacturers of a trademarked product. The ostensible purpose of the Sealy licensing scheme, as we have noted, is to strengthen the competitive position of a group of manufacturers by the creation of a distinctive brand identity in the minds of consumers. Implementation of this purpose has several aspects: trademark protection; promotion of the Sealy brand; and exploitation of the consumer demand thus created, both by signing up an adequate number of licensees and by assuring that each assiduously cultivates his market for the brand. None of these functions, we submit, requires or justifies a permanent territorial restriction.

(1) There is no danger that without the restriction the Sealy trademark might be forfeited[9] or its value diminished. Licensed as it is to numerous unaffiliated manufacturers, the Sealy mark in no event serves to identify the company that produces the trademarked item. Its function—clearly a legitimate

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[9] In suggesting that there is such a danger, *Denison Mattress Factory* v. *Spring-Air Co.*, 308 F. 2d 403 (C.A. 5), was, in our opinion, in error.

and sufficient basis for trademark protection under the Lanham Act—is quite different: to indicate a product that is uniform because its quality is controlled, albeit it is manufactured by more than one firm. See 15 U.S.C. 1055; Schniderman, *Trade-Mark Licensing—A Saga of Fantasy and Fact,* 14 Law & Contemp. Prob. 248; Comment, 72 Yale L. J. 1171. If Sealy maintains adequate quality control, the public has no interest in the particular manufacturer and the trademark is secure and its worth unimpaired. *Dawn Donut Co.* v. *Hart's Food Stores, Inc.,* 267 F. 2d 358, 366–367 (C.A. 2); *Alligator Co.* v. *Robert Bruce, Inc.,* 176 F. Supp. 377, 378–379 (E.D. Pa.). If the quality of the product varies from manufacturer to manufacturer, the Act is violated because all of the goods covered by a trademark must be the same in nature and quality (15 U.S.C. 1055). In either event a territorial restriction is wholly irrelevant.

(2) Successful fulfillment of the Sealy group's promotional activities does not depend upon a territorial restriction. It is, to be sure, possible that without division of territories some licensees might benefit more from national advertising by Sealy, Inc. than others.[10] But that would be easily correctible by requiring each licensee to contribute to the advertising budget of Sealy, Inc. in proportion to his sales, a solution that would avoid the drastic anti-competitive effects of the territorial restriction. It is likewise

[10] However, it would appear that the same possibility exists despite the territorial allocation, since advertising in even a national medium may have a greater impact in some areas than in others.

conceivable that a Sealy licensee would be reluctant to engage in local advertising to back up Sealy, Inc.'s national program if the sales generated by his efforts could be skimmed off by other licensees. But all businessmen run the risk that their advertising may inadvertently benefit their competitors; that has not discouraged advertising. Moreover, since mattresses are bulky and shipping costs must therefore be high, each Sealy manufacturer enjoys an inherent competitive advantage in his home area, so that even without a territorial restriction he is likely to be the principal beneficiary of local advertising.

In this connection, it is relevant to note that from the standpoint of the policy of the antitrust laws a restriction designed to increase advertising expenditures is, at best, a mixed blessing. While advertising may promote competition by broadening the consumer's range of choice, it may also weaken competition by raising the barriers to new entry into a market or industry and by impairing the position of smaller firms that cannot spend heavily for advertising. See Bain, *Barriers to New Competition*, p. 142. The very success of the Sealy scheme may make the bedding industry one where only a very large firm or one that belongs to a Sealy-type group can survive.[11] If competition within such groups is foreclosed, the ultimate result is likely to be a severe diminution in the amount and vigor of competition in the industry.

[11] Six manufacturing groups in the mattress industry are operating under Sealy-type arrangements. Hearings on S. 1396 before the Subcommittee on Patents, Trademarks, and Copyrights of the Senate Judiciary Committee, 87th Cong., 1st Sess., p. 43.

(3) Also unpersuasive is the suggestion stressed by appellee in this Court (see p. 14, *supra*) that manufacturers cannot be induced to accept a trademark license unless assured of protection against competition by other licensees and that therefore the territorial restriction is necessary to enable Sealy bedding to compete effectively against other brands. We agree that it is often desirable to encourage new entry into an industry and that high initial or starting-up costs may place the new manufacturer at a serious disadvantage in competing with established firms. But this would at most justify a temporary territorial restriction for new members of the Sealy group (Sealy itself not being a new entrant); it would not entitle long-established members of the Sealy group to the permanent benefit of exclusive territories. Perpetual protection against intra-brand competition, which penalizes the efficient members of the group and shields the others from the consequences of their inefficiencies, limits competition far more drastically than the difficulties of new entry can reasonably be thought to require.

Nor is it a plausible supposition that the effectiveness of each licensee's exploitation of the consumer demand for Sealy products is increased by limiting him to a particular territory. The territorial restriction has apparently had a contrary effect: licensees jealously hold on to areas that they are unable to exploit adequately.[12] Insistence that each licensee

[12] The president of Sealy compared the licensees to "the child who has three large lollypops the size of which is such that she cannot put more than one in her mouth and, there-

shoulder primary responsibility for cultivating a particular territory would (without precluding competition among the licensees) serve the interest of the Sealy group as a whole better than an ironclad division of territories. More Sealy bedding would be sold if licensees were free to sell outside their assigned territories in areas which, for one reason or another, were not being exploited to the maximum. The necessity for the restriction is further doubtful since it is in each licensee's own interest to exploit intensively his immediate area, where it is presumably cheaper (because of lower shipping costs) for him to sell.

B. WHATEVER PLAUSIBILITY THE SUGGESTED JUSTIFICATIONS FOR THE TERRITORIAL RESTRAINT MIGHT OTHERWISE HAVE IS CRITICALLY UNDERMINED BY THE FACT THAT THE RESTRAINT WAS—IN EFFECT—IMPOSED BY THE VERY SELLERS WHO HAVE THE MOST TO GAIN FROM ELIMINATING INTRA-BRAND COMPETITION

We have suggested that the arguable justifications for a perpetual allocation of exclusive territories

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fore, the other two virtually are of no particular value to her, but you know how kids are, try and get them to give up anything that they have. The similarity might sound strange, but that is exactly the same position I find myself in when I ask any Sealy licensee to relinquish a little piece of territory regardless of how miserable a job they may be doing in it." (GX 385, R. 683.) Thus, although it was agreed as early as 1936 that licensees should release territories to attract new licensees into the system (Fdg. 89, R. 92), efforts to secure economic coverage of the whole country and to limit licensees' preserves to "normal trading area[s]" were a never-ending uphill struggle (see Fdg. 89, R. 93; Fdg. 90, R. 93; Fdg. 91, R. 93; Fdg. 97, R. 95; Fdg. 98, R. 95). As late as 1956, a management consulting firm, making recommendations concerning the rearrangement of territories in order to obtain complete coverage, pointed out that "many licensees are not exploiting all their territory" (Fdg. 108, R. 100).

among the licensees of a trademarked item are exceedingly tenuous. We think they are plainly too tenuous to warrant the taking of evidence.[13] But we need not rest solely on that proposition. There is an additional highly material consideration here—that the source of the territorial restriction is not an independent third party but the very sellers whom the restriction is designed to shield from competition. This factor, as we shall show, serves sharply to distinguish the present case from *White Motor Co.* v. *United States*, 372 U.S. 253, where this Court reserved decision on whether to apply a rule of *per se* illegality to territorial restrictions imposed by a manufacturer on his distributors.[14]

The self-interest of a manufacturer lies in compressing his distributors' profit margin as far as is compatible with effective distribution. If, therefore, a manufacturer insists that his distributors agree to a territorial restriction, there is some basis for assuming that the primary purpose and likely effect of the restriction may be to enable the manufacturer to compete more effectively with other manufacturers, rather than to enable the distributors to enjoy the fruits of monopoly. If the distributors were the

[13] Since, as we have shown, a permanent (or very long-term) territorial restriction like that at bar is in any event broader than reasonably necessary, the doctrine of "ancillary restraints" is clearly inapplicable. *United States* v. *Columbia Pictures Corp.*, 189 F. Supp. 153, 178 (S.D. N.Y.),

[14] The Court deemed a decision on the question premature since (1) it was the first case involving such a restriction to come before the Court and (2) there was no record, the case having been decided in the district court on motion for summary judgment.

source of the restriction, the natural assumption would be the opposite: that it was indeed a device whereby the distributors expected to attain a level of profits that free intra-brand competition would prevent. "If it were clear that the territorial restrictions involved in this case had been induced solely or even primarily by appellant's dealers and distributors," the restrictions would be illegal *per se.* *White Motor Co.* v. *United States*, 372 U.S. 253, 267 (Brennan, J., concurring); cf. *United States* v. *General Motors Corp.*, 384 U.S. 127.

It is conceivable that distributors might agree not to compete with each other in order to strengthen the brand rather than in order to reap monopoly profits. It is similarly conceivable that a group of manufacturers of different brands of a product might divide territories in order to strengthen their competitive position vis-à-vis other manufacturers of the same or competing products—yet despite this possibility it is well settled that such divisions of territory are illegal *per se.*[15] The courts have wisely recognized that the desire for the enhanced profits that insulation from competition enables is in the vast majority of cases the decisive motivation for entering into such agreements, and that other reasons are so unlikely to be the real or principal reasons that they may be disregarded.

This principle is equally applicable where the manufacturers of a single brand agree not to compete in the sale of that brand. The possibility that they are

[15] The decisions in this Court so holding are cited at p. 12, *supra*.

motivated more by concern with promoting interbrand competition than by concern with reaping monopoly profits—even if such could be proved—is, we submit, too remote to require evidentiary inquiry, especially when we recall how inherently unlikely it is that a perpetual division of territories is truly necessary to the promotion of the brand. One is entitled to doubt that justifications so tenuous constituted the real motive for the restriction.

Nor is there doubt that the territorial restriction in this case is, despite the mediation of Sealy, Inc., in essence one imposed by the licensees themselves. Sealy, unlike a manufacturer in relation to his distributors, is not an independent firm responsive to interests other than those of its licensees. It is completely dominated by the licensees. More than 90 percent of its stock is owned by individual licensees and the balance is owned by Sealy's officers, whose positions depend upon the good will of the licensees. Independent direction of the corporation is further precluded by the provision of the bylaws barring from the board of directors anyone who is not a stockholder or a representative of a licensee.

The pattern of Sealy's ownership might, perhaps, not be a controlling consideration if its income were so great that the licensees' stake in its prosperity as stockholders was comparable to their interests as licensees. But Sealy's income, generated by royalties from the licenses, is equal to only about 3 percent of the licensees' total sales of Sealy products (see GX 1107, R. 1315–1319). For the licensees to operate Sealy so as to maximize its profits rather than their

own would be a clear case of the tail wagging the dog. We think it obvious, therefore, that the policies of Sealy—including the territorial allocation it nominally imposes on the licensees—reflect not an independent judgment on how best to increase the sales of Sealy products as a whole but the licensees' collective judgment on how best to maximize the profits of each.[16] Thus, there is every reason to believe that these territorial restrictions were designed solely or primarily to allow the Sealy manufacturers to escape competition—just as if they were the product of agreement among the licensees directly.

We do not suggest that all restrictive agreements that are illegal *per se* when considered alone are also illegal *per se* if adopted in the context of a joint ven-

[16] If Sealy were independently run, it would surely not tolerate the inefficiencies stemming from licensees' jealous insistence upon holding on to areas within their assigned territories which they cannot adequately exploit (see p. 20 and n. 12, *supra*). Nor would it tolerate the mislocation of factories and warehouses that has apparently resulted from the territorial restriction. Thus, a 1954 report of Sealy's Planning and Expansion Committee commented that "many trading areas in this entire country are not producing the volume of Sealy business, that could reasonably be expected * * *. We believe that in many instances, territories are entirely too far from the sources of supply, or in other words, that they are entirely too far from the Sealy plant which serves them. Therefore, additional factories, or warehouses, should be established to serve those areas. That solution, or some other, undoubtedly can be or at least should be found to bring all territories up to the reasonable par, and by so doing, it undoubtedly would increase the overall volume of Sealy, Inc., tremendously" (GX 77, R. 356–357; Fdg. 45, R. 79).

ture. Such agreements may be legal when necessary to further the purposes of a legitimate such venture. See *United States* v. *Columbia Pictures Corp.,* 189 F. Supp., 153, 178 (S.D.N.Y.).[17] For the reasons set forth above, however, there is little if any possibility that a restriction like that at bar can be justified even in the context of a joint venture. The possibility of justification is so remote that a rule of *per se* illegality seems clearly appropriate.

So urging, we rely upon a combination of factors: the danger to competition that the restriction imports; the lack of plausibility of the suggested justifications for so severe a restraint on competition; and the source of the restraint—the competitors themselves. Taken together, these factors indicate a restraint so inherently likely to be undue and unreasonable that it should be so regarded as a matter of law. The likelihood of harm to the interests protected by the antitrust laws far outweighs the chance that the restraint may be innocuous or beneficial. This justifies, in the interest of effective antitrust administration, a definite rule outlawing the practice. While we argue neither that all practices which foreclose intra-brand competition are illegal nor that competitors may never, regardless of circumstances, agree among themselves not to compete,[18] we submit that when all of the critical

[17] For example, it may be necessary for a legitimate selling agency selling abroad to allocate sales among its members.

[18] Thus, we do not challenge the proposition that a firm which sells one of its plants may grant the buyer a reasonable covenant, limited in duration, not compete with him. See, also, n. 17, *supra.*

to

factors are present—as in this case—the challenged practice is clearly "too dangerous to sanction" (*White Motor Co.* v. *United States,* 372 U.S. 253, 263).

CONCLUSION

The judgment below should be reversed and the case remanded to the district court with directions to enter an appropriate injunction against continuance of the territorial restraint.

Respectfully submitted.

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